United States Court of Appeals

for the Second Circuit

REPLY BRIEF

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1573-A

H. PERINE,

Plaintiff-Appellant,

-against-

WILLIAM NORTON & COMPANY, INC., WILLIAM NORTON, ELINORE NORTON and DESIGNCRAFT JEWEL INDUSTRIES, INC.,

Defendants.

ON APPEAL FROM UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PLAINTIFF-APPELLANT'S REPLY BRIEF

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Cases: Page

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I.

NORTON in its brief never points to any portion of present Regulation 16b-2 or its predecessors which imposes liability on underwriters who are officers, directors or pre-existing 10 per cent beneficial owners but not on underwriters, such as NORTON, who become 10 per cent beneficial owners and have equally well-established 16-b liability under

Stella v. Graham-Paige. Instead, NORTON assumes, rather than demonstrates or identifies, such special distinction or exemption in the Regulation.

Thus, in its brief (pp. 14-24), NORTON in respect of the SEC's earlier regulations and accompanying releases on the underwriter's exemption from 16(b) liability, emphasizes the words "officer", "director" and "beneficial owner, directly or indirectly, of more than ten per cent of any class of equity security" (brief, pp. 16, 20) and the words "beneficial stockholders of the issuer" (p. 19) as evidence of an intent to make the conditions or requirements of present Regulation 16b-2 applicable only to underwriters who are pre-existing insiders.

This assumes, however, that the words "beneficial owner" or "principal stockholders" encompass only pre-existing 10% stockholders when it is evident that such words or terms were being used in their statutory sense, that is, with the same meaning as the term "beneficial owner of more than 10 per centum of any class of any equity security" is used in Section 16 itself. Thus, in its 1947 release (NORTON's brief, p. 21), the SEC specifically stated that the rules in question "exempt bona fide underwriting transactions by dealers who fall within one of the three classes of

"insiders" [director, officer and 10% stockholder] specified in Section 16, or by dealer firms with which such persons are connected". And again, in the 1959 release that accompanied present Regulation 16b-2, after first stating that Section 16(b) is applicable to short-swing profits realized by a "beneficial owner of more than 10% of any class of any equity securities...or by a director or officer of the issuer of such a security (sometimes referred to herein as 'insiders')", it is then stated: "Rules 16b-2 and 16c-2 have provided exemptions from the above provisions for certain distributing transactions under specified conditions including, among others the requirement that persons other than 'insiders' be participating in the distributions to an equal extent and on terms at least as favorable as the 'insiders'."

One would suppose that if the SEC were to specially distinguish the NORTON-type underwriter from all other underwriters, it would say something about such special distinction in a clear and specific manner. Just the contrary is true, however, for as pointed out in plaintiff's main brief (pp. 16-17) the SEC's releases, as well as other public statements of the SEC, expressly and specifically

set forth the SEC's position that an underwriter, such as NORTON, which, owning no prior stock, purchases and sells over 10% of an issuer's stock is subject to the recapture provisions of 16(b) unless it complies with the conditions of the exemption contained in Regulation 16b-2, including the condition that it share upon the same terms that it enjoyed at least 50% of the underwriting with other broker-dealers who are not themselves insiders within the purview of 16(b).

Moreover, NORTON realizes that its position is basically self-contradictory. For if Regulation 16b-2 is inapplicable to NORTON-type underwriters, then such underwriters have no exemption at all from the provisions of Section 16(b). In an attempt to surmount this contradiction, NORTON contends in its brief (p. 7) that all the conditions or requirements of Regulation 16b-2 are applicable to a NORTON-type underwriter except the condition that it share upon the same terms that it enjoys at least one-half of the underwriting with other non-insider underwriters. Such contention that the NORTON-type underwriter need only partially comply with the regulation is plainly untenable.

NORTON's contention that its profits should not be

subject to recapture because it was only a "conduit" proves too much because such contention is equally applicable to all underwriters including officers and directors. However, NORTON in its brief (p. 7) specifically "concedes that an insider-underwriter [of the non-NORTON type] would have to comply with Rule 16b-2(a)(3) [the equal participation condition] to qualify for the exemption."

2.

NORTON states in its brief (p. 11) that, for 16(b) liability to attach, "there must be proof of actual abuse of insider information" and proof of an intent to profit on the basis of such information. This is patently erroneous, for this Court has specifically and repeatedly held that an objective standard of liability obtains under 16(b). E.g., Feder v. Martin-Marietta Corporation, 406 F.2d 260, 262 (2nd Cir. 1969), cert. denied, 396 U.S. 1036; Newmark v. RKO General, Inc., 425 F.2d 348, 350-1 (2nd Cir. 1970), cert denied, 400 U.S. 854.

NORTON miscites in this connection the Supreme Court's decision in Kern County Land Company v. Occidental Petroleum, 411 U.S. 582 (1973), involving purchase of over 10% of the issuer's stock by a tender offer that was resisted by the

issuer and the sale of such stock as the result of a defensive merger of the issuer into a third company with the 10% beneficial owner having no control over such merger. Kern did not vitiate the objective standard of liability under 16(b). On the contrary, the Supreme Court stated therein: "The statute [16(b)] requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information." (411 U.S., at p. 595) (underlining supplied).

3.

NORTON asserts that the imposition of liability on NORTON in this case would "wreck (sic) havoc upon the securities industry" (brief, p. 8) and further "would severely restrict future public offerings for no legitimate reason" (p. 26).

Section 16(b) does not apply to new issuers, since their securities are not listed on any exchange or registered under Section 12(g) of the Act. Thus a single underwriter, as it often does, could purchase and sell the entire original issue of a new public corporation and suffer no 16(b) liability.

In the situation in which a public company subject

to 16(b) sells additional stock to an underwriter in an amount large enough to equal or exceed 10 per cent of its then issued and outstanding stock the principal underwriter shares the purchase and sale with other underwriters no one of whom has more than 10 per cent of the outstanding. The principal underwriter can even purchase and sell more than 10 per cent if it allots an equal amount to other underwriters none of whom singly has 10 per cent. This is undoubtedly one of the reasons for syndicates, in addition to risk-sharing and assistance with distribution.

The instant case is the only reported case involving the liability of an underwriter under 16(b) since its enactment in 1934. The complete paucity of such litigation in a period of about 40 years shows that the securities industry has experienced no difficulty in accommodating itself to Regulation 16b-2.

The condition that insiders share the underwriting equally with non-insiders is extremely flexible in that the mathematics are such that compliance can take any one of a great number of forms. Thus, in this case, such condition would have been complied with if NORTON had shared the underwriting equally with three other underwriters, (since none would have over 10 per cent of the outstanding)

or if NORTON had shared the underwriting equally with a group composed of two or more other underwriters, etc. NORTON could accordingly have purchased and sold almost 20% of Designcraft's outstanding stock while at the same time complying with Regulation 16b-2.

It is very common for the board of directors of a public company to include a representative of that company's investment banking or underwriting firm. However, NORTON is unable to tell us why it would wreak havoc upon the securities industry to apply the conditions of Regulation 16b-2 only to NORTON-type underwriters, and not to other insider-underwriters who, NORTON specifically concedes, must comply with such conditions.

Nor for that matter is NORTON able to tell us why it could not comply with the conditions of Regulation 16b-2, including the conditions of equal participation, or why it would wreak havoc upon the securities industry to have required it to do so. The only barrier to such compliance by NORTON was NORTON's avarice and the purported policy arguments made by NORTON subserve not the public interest but only such avarice.

Respectfully submitted,

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STANLEY L. KAUFMAN
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Of Counsel

September 26, 1974.

STATE OF NEW YORK)
) SS.:
COUNTY OF NEW YORK)

ENNA PADIN, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 83-20 Britton Avenue, Elmhurst, New York. That on the 23rd day of September 1974 deponent served the within Reply Brief upon the attorneys listed below at their respective addresses, the addresses designated by said attorneys for that purpose by depositing two copies of same enclosed in a postpaid properly addressed wrapper, in an official depository maintained at 41 East 42nd Street, New York, New York 10017 under the exclusive care and custody of the United States Post Office Department within the State of New York.

Feldshuh & Frank
144 E. 44th Street
New York, N. Y. 10017

Enna Padin
Enna Padin

Sworn to before me this
23rd day of September, 1974.

Stanley L. Kaufman

STANLEY L. KAUFMAN
Notary Public, State of New York
No. 31-7183000
Qualified in New York County
Commission Expires March 30, 1976